

KEYCORP /NEW/
Form 10-Q
November 07, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended September 30, 2016
Commission File Number 001-11302

Exact name of registrant as specified in its charter:

Ohio 34-6542451
State or other jurisdiction of I.R.S. Employer
incorporation or organization Identification Number:
127 Public Square, Cleveland, Ohio 44114-1306
Address of principal executive offices: Zip Code:
(216) 689-3000
Registrant's telephone number, including area code:

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Shares with a par value of \$1 each 1,080,711,946 shares

Title of class Outstanding at November 3, 2016

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KEYCORP

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Throughout the Notes to Consolidated Financial Statements (Unaudited) and Management's Discussion & Analysis of Financial Condition & Results of Operations, we use certain acronyms and abbreviations as defined in Note 1 ("Basis of Presentation and Accounting Policies") that begins on page 10.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Consolidated Balance Sheets

in millions, except per share data

| | September 30, 2016 (Unaudited) | December 31, 2015 | September 30, 2015 (Unaudited) |
|---|--------------------------------------|----------------------|--------------------------------------|
| ASSETS | | | |
| Cash and due from banks | \$ 749 | \$ 607 | \$ 470 |
| Short-term investments | 3,216 | 2,707 | 1,964 |
| Trading account assets | 926 | 788 | 811 |
| Securities available for sale | 20,540 | 14,218 | 14,376 |
| Held-to-maturity securities (fair value: \$9,048, \$4,848, and \$4,940) | 8,995 | 4,897 | 4,936 |
| Other investments | 747 | 655 | 691 |
| Loans, net of unearned income of \$1,069, \$646, and \$645 | 85,528 | 59,876 | 60,085 |
| Less: Allowance for loan and lease losses | 865 | 796 | 790 |
| Net loans | 84,663 | 59,080 | 59,295 |
| Loans held for sale ^(a) | 1,137 | 639 | 916 |
| Premises and equipment | 1,023 | 779 | 771 |
| Operating lease assets | 430 | 340 | 315 |
| Goodwill | 2,480 | 1,060 | 1,060 |
| Other intangible assets | 426 | 65 | 74 |
| Corporate-owned life insurance | 4,035 | 3,541 | 3,516 |
| Derivative assets | 1,304 | 619 | 793 |
| Accrued income and other assets | 3,480 | 3,290 | 3,346 |
| Discontinued assets (including \$3 and \$4 million of portfolio loans at fair value, and \$169 million of portfolio loans held for sale at fair value, see Note 12) | 1,654 | 1,846 | 2,086 |
| Total assets | \$ 135,805 | \$ 95,131 | \$ 95,420 |
| LIABILITIES | | | |
| Deposits in domestic offices: | | | |
| NOW and money market deposit accounts | \$ 56,432 | \$ 37,089 | \$ 37,301 |
| Savings deposits | 5,335 | 2,341 | 2,338 |
| Certificates of deposit (\$100,000 or more) | 4,601 | 2,392 | 2,001 |
| Other time deposits | 5,793 | 3,127 | 3,020 |
| Total interest-bearing deposits | 72,161 | 44,949 | 44,660 |
| Noninterest-bearing deposits | 32,024 | 26,097 | 25,985 |
| Deposits in foreign office — interest-bearing | — | — | 428 |
| Total deposits | 104,185 | 71,046 | 71,073 |
| Federal funds purchased and securities sold under repurchase agreements | 602 | 372 | 407 |
| Bank notes and other short-term borrowings | 809 | 533 | 677 |
| Derivative liabilities | 850 | 632 | 676 |
| Accrued expense and other liabilities | 1,739 | 1,605 | 1,562 |
| Long-term debt | 12,622 | 10,184 | 10,308 |
| Total liabilities | 120,807 | 84,372 | 84,703 |
| EQUITY | | | |
| Preferred stock | 1,165 | 290 | 290 |
| | 1,257 | 1,017 | 1,017 |

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| | | | | |
|---|------------|-----------|-----------|---|
| Common shares, \$1 par value; authorized 1,400,000,000 shares; issued 1,256,705,117, 1,016,969,905, and 1,016,969,905 shares | | | | |
| Capital surplus | 6,359 | 3,922 | 3,914 | |
| Retained earnings | 9,260 | 8,922 | 8,764 | |
| Treasury stock, at cost (174,650,040, 181,218,648, and 181,685,035 shares) | (2,863 |) (3,000 |) (3,008 |) |
| Accumulated other comprehensive income (loss) | (182 |) (405 |) (272 |) |
| Key shareholders' equity | 14,996 | 10,746 | 10,705 | |
| Noncontrolling interests | 2 | 13 | 12 | |
| Total equity | 14,998 | 10,759 | 10,717 | |
| Total liabilities and equity | \$ 135,805 | \$ 95,131 | \$ 95,420 | |

(a) Total loans held for sale include Real estate — residential mortgage loans held for sale at fair value of \$62 million at September 30, 2016.
See Notes to Consolidated Financial Statements (Unaudited).

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Consolidated Statements of Income

dollars in millions, except per share amounts

(Unaudited)

INTEREST INCOME

| | Three months ended September 30, | | Nine months ended September 30, | |
|-------------------------------|-------------------------------------|--------|------------------------------------|----------|
| | 2016 | 2015 | 2016 | 2015 |
| Loans | \$ 746 | \$ 542 | \$ 1,875 | \$ 1,597 |
| Loans held for sale | 10 | 10 | 23 | 29 |
| Securities available for sale | 88 | 75 | 237 | 217 |
| Held-to-maturity securities | 30 | 24 | 78 | 72 |
| Trading account assets | 4 | 5 | 17 | 15 |
| Short-term investments | 7 | 1 | 17 | 5 |
| Other investments | 5 | 4 | 10 | 14 |
| Total interest income | 890 | 661 | 2,257 | 1,949 |

INTEREST EXPENSE

| | | | | |
|---|-----|-----|-------|-------|
| Deposits | 49 | 27 | 114 | 79 |
| Bank notes and other short-term borrowings | 2 | 2 | 7 | 6 |
| Long-term debt | 59 | 41 | 155 | 118 |
| Total interest expense | 110 | 70 | 276 | 203 |
| NET INTEREST INCOME | 780 | 591 | 1,981 | 1,746 |
| Provision for credit losses | 59 | 45 | 200 | 121 |
| Net interest income after provision for credit losses | 721 | 546 | 1,781 | 1,625 |

NONINTEREST INCOME

| | | | | |
|--|-----|-----|-------|-------|
| Trust and investment services income | 122 | 108 | 341 | 328 |
| Investment banking and debt placement fees | 156 | 109 | 325 | 318 |
| Service charges on deposit accounts | 85 | 68 | 218 | 192 |
| Operating lease income and other leasing gains | 6 | 15 | 41 | 58 |
| Corporate services income | 51 | 57 | 154 | 143 |
| Cards and payments income | 66 | 47 | 164 | 136 |
| Corporate-owned life insurance income | 29 | 30 | 85 | 91 |
| Consumer mortgage income | 6 | 3 | 11 | 10 |
| Mortgage servicing fees | 15 | 11 | 37 | 33 |
| Net gains (losses) from principal investing | 5 | 11 | 16 | 51 |
| Other income ^(a) | 8 | 11 | 61 | 35 |
| Total noninterest income | 549 | 470 | 1,453 | 1,395 |

NONINTEREST EXPENSE

| | | | | |
|---|-------|-----|-------|-------|
| Personnel | 594 | 426 | 1,425 | 1,223 |
| Net occupancy | 73 | 60 | 193 | 191 |
| Computer processing | 70 | 41 | 158 | 121 |
| Business services and professional fees | 76 | 40 | 157 | 115 |
| Equipment | 26 | 22 | 68 | 66 |
| Operating lease expense | 15 | 11 | 42 | 34 |
| Marketing | 32 | 17 | 66 | 40 |
| FDIC assessment | 21 | 8 | 38 | 24 |
| Intangible asset amortization | 13 | 9 | 28 | 27 |
| OREO expense, net | 3 | 2 | 6 | 5 |
| Other expense | 159 | 88 | 355 | 258 |
| Total noninterest expense | 1,082 | 724 | 2,536 | 2,104 |

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| | | | | |
|--|---------|--------|---------|---------|
| INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES | 188 | 292 | 698 | 916 |
| Income taxes | 16 | 72 | 141 | 230 |
| INCOME (LOSS) FROM CONTINUING OPERATIONS | 172 | 220 | 557 | 686 |
| Income (loss) from discontinued operations, net of taxes of \$1, (\$2), \$3, and \$3 (see Note 12) | 1 | (3) | 5 | 5 |
| NET INCOME (LOSS) | 173 | 217 | 562 | 691 |
| Less: Net income (loss) attributable to noncontrolling interests | 1 | (2) | — | 1 |
| NET INCOME (LOSS) ATTRIBUTABLE TO KEY | \$172 | \$219 | \$562 | \$690 |
| Income (loss) from continuing operations attributable to Key common shareholders | \$165 | \$216 | \$540 | \$668 |
| Net income (loss) attributable to Key common shareholders | 166 | 213 | 545 | 673 |
| Per common share: | | | | |
| Income (loss) from continuing operations attributable to Key common shareholders | \$.17 | \$.26 | \$.61 | \$.79 |
| Income (loss) from discontinued operations, net of taxes | — | — | .01 | .01 |
| Net income (loss) attributable to Key common shareholders ^(b) | .17 | .26 | .62 | .80 |
| Per common share — assuming dilution: | | | | |
| Income (loss) from continuing operations attributable to Key common shareholders | \$.16 | \$.26 | \$.60 | \$.78 |
| Income (loss) from discontinued operations, net of taxes | — | — | .01 | .01 |
| Net income (loss) attributable to Key common shareholders ^(b) | .17 | .25 | .61 | .79 |
| Cash dividends declared per common share | \$.085 | \$.075 | \$.245 | \$.215 |
| Weighted-average common shares outstanding (000) | 982,080 | 1,430 | 880,824 | 839,758 |
| Effect of convertible preferred stock | — | — | — | — |
| Effect of common share options and other stock awards | 12,587 | 7,450 | 8,965 | 7,613 |
| Weighted-average common shares and potential common shares outstanding (000) ^(c) | 994,667 | 18,880 | 889,789 | 847,371 |

For the three months ended September 30, 2016, net securities losses totaled \$6 million. For the three months ended September 30, 2015, net securities gains (losses) totaled less than \$1 million. For the three months ended September 30, 2016, and September 30, 2015, we did not have any impairment losses related to securities.

(b)EPS may not foot due to rounding.

(c) Assumes conversion of common share options and other stock awards and/or convertible preferred stock, as applicable.

See Notes to Consolidated Financial Statements (Unaudited).

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Consolidated Statements of Comprehensive Income

| in millions | Three months ended September 30, 2016 | 2015 | Nine months ended September 30, 2016 | 2015 |
|--|--|-------|---|-------|
| (Unaudited) | | | | |
| Net income (loss) | \$173 | \$217 | \$562 | \$691 |
| Other comprehensive income (loss), net of tax: | | | | |
| Net unrealized gains (losses) on securities available for sale, net of income taxes of (\$18), \$33, \$93 and \$35 | (28 |)54 | 159 | 58 |
| Net unrealized gains (losses) on derivative financial instruments, net of income taxes of (\$24), \$28, \$32, and \$37 | (41 |)48 | 53 | 63 |
| Foreign currency translation adjustments, net of income taxes of (\$1), (\$3), \$3, and (\$11) | (2 |)5 |) 5 | (18) |
| Net pension and postretirement benefit costs, net of income taxes of \$1, (\$15), \$6, and (\$12) | 3 | (24 |) 6 | (19) |
| Total other comprehensive income (loss), net of tax | (68 |)73 | 223 | 84 |
| Comprehensive income (loss) | 105 | 290 | 785 | 775 |
| Less: Comprehensive income attributable to noncontrolling interests | 1 | (2 |) — | 1 |
| Comprehensive income (loss) attributable to Key | \$104 | \$292 | \$785 | \$774 |

See Notes to Consolidated Financial Statements (Unaudited).

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Consolidated Statements of Changes in Equity

| dollars in millions, except per share amounts (Unaudited) | Key Shareholders' Equity | | | | | | | Accumulated | |
|---|---|--|--------------------|------------------|--------------------|----------------------|-------------------------------|--|-----------------------------|
| | Preferred Shares Outstanding (000) | Common Shares Outstanding (000) | Preferred Stock | Common Shares | Capital Surplus | Retained Earnings | Treasury Stock, at Cost | Other Comprehensive Income (Loss) | Noncontrolling Interests |
| BALANCE AT DECEMBER 31, 2014 | 2,905 | 859,403 | \$ 291 | \$ 1,017 | \$3,986 | \$8,273 | \$(2,681) | \$ (356) | \$ 12 |
| Net income (loss) | | | | | | 690 | | | 1 |
| Other comprehensive income (loss): | | | | | | | | | |
| Net unrealized gains (losses) on securities available for sale, net of income taxes of \$35 | | | | | | | | 58 | |
| Net unrealized gains (losses) on derivative financial instruments, net of income taxes of \$37 | | | | | | | | 63 | |
| Foreign currency translation adjustments, net of income taxes of (\$11) | | | | | | | | (18) | |
| Net pension and postretirement benefit costs, net of income taxes of (\$12) | | | | | | | | (19) | |
| Deferred compensation | | | | | 13 | | | | |
| Cash dividends declared on common shares (\$.215 per share) | | | | | | (182) | | | |
| Cash dividends declared on Noncumulative Series A Preferred Stock (\$5.8125 per share) | | | | | | (17) | | | |
| Common shares repurchased | | (31,267) | | | | | (448) | | |
| Series A Preferred Stock exchanged for common shares | (5) | 33 | (1) | | | | 1 | | |
| Common shares reissued (returned) for stock options and other employee benefit plans | | 7,116 | | | (85) | | 120 | | |
| Net contribution from (distribution to) noncontrolling interests | | | | | | | | | (1) |
| | 2,900 | 835,285 | \$ 290 | \$ 1,017 | \$3,914 | \$8,764 | \$(3,008) | \$ (272) | \$ 12 |

BALANCE AT
SEPTEMBER 30, 2015

| | | | | | | | | | |
|---|--------|-----------|----------|----------|----------|----------|-----------|-----------|-------|
| BALANCE AT DECEMBER 31, 2015 | 2,900 | 835,751 | \$ 290 | \$ 1,017 | \$ 3,922 | \$ 8,922 | \$(3,000) | \$ (405) | \$ 13 |
| Net income (loss) | | | | | | 562 | | | — |
| Other comprehensive income (loss): | | | | | | | | | |
| Net unrealized gains (losses) on securities available for sale, net of income taxes of \$93 | | | | | | | | 159 | |
| Net unrealized gains (losses) on derivative financial instruments, net of income taxes of \$32 | | | | | | | | 53 | |
| Foreign currency translation adjustments, net of income taxes of \$3 | | | | | | | | 5 | |
| Net pension and postretirement benefit costs, net of income taxes of \$6 | | | | | | | | 6 | |
| Deferred compensation | | | | | (8) | | | | |
| Cash dividends declared on common shares (\$.245 per share) | | | | | | (207) | | | |
| Cash dividends declared on Noncumulative Series A Preferred Stock (\$5.8125 per share) | | | | | | (17) | | | |
| Common shares issued | | 239,735 | | 240 | 2,591 | | | | |
| Common shares repurchased | | (6,122) | | | | | (73) | | |
| Issuance of Preferred Stock | 14,021 | | 875 | | (6) | | | | |
| Common shares reissued (returned) for stock options and other employee benefit plans | | 12,691 | | | (140) | | 210 | | |
| Net contribution from (distribution to) noncontrolling interests | | | | | | | | (11) | |
| BALANCE AT SEPTEMBER 30, 2016 | 16,921 | 1,082,055 | \$ 1,165 | \$ 1,257 | \$ 6,359 | \$ 9,260 | \$(2,863) | \$ (182) | \$ 2 |

See Notes to Consolidated Financial Statements (Unaudited).

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Consolidated Statements of Cash Flows

| in millions | Nine months ended September 30, 2016 2015 | |
|--|---|-----------------|
| (Unaudited) | | |
| OPERATING ACTIVITIES | | |
| Net income (loss) | \$ 562 | \$ 691 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Provision for credit losses | 200 | 121 |
| Depreciation, amortization and accretion expense, net | 293 | 176 |
| Increase in cash surrender value of corporate-owned life insurance | (76) | (75) |
| Stock-based compensation expense | 66 | 47 |
| FDIC reimbursement (payments), net of FDIC expense | 7 | (1) |
| Deferred income taxes (benefit) | (63) | (70) |
| Proceeds from sales of loans held for sale | 5,181 | 5,362 |
| Originations of loans held for sale, net of repayments | (5,516) | (5,428) |
| Net losses (gains) on sales of loans held for sale | (92) | (75) |
| Net losses (gains) from principal investing | (16) | (51) |
| Net losses (gains) and writedown on OREO | 3 | 2 |
| Net losses (gains) on leased equipment | 10 | (8) |
| Net securities losses (gains) | 6 | 1 |
| Net losses (gains) on sales of fixed assets | 13 | 6 |
| Net decrease (increase) in trading account assets | (138) | (61) |
| Other operating activities, net | 420 | (388) |
| NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES | 860 | 249 |
| INVESTING ACTIVITIES | | |
| Cash received (used) in acquisitions, net of cash acquired | (481) | — |
| Net decrease (increase) in short-term investments, excluding acquisitions | (509) | 2,305 |
| Purchases of securities available for sale | (4,203) | (3,314) |
| Proceeds from sales of securities available for sale | 4,248 | 11 |
| Proceeds from prepayments and maturities of securities available for sale | 2,867 | 2,357 |
| Proceeds from prepayments and maturities of held-to-maturity securities | 1,048 | 846 |
| Purchases of held-to-maturity securities | (5,150) | (770) |
| Purchases of other investments | (28) | (24) |
| Proceeds from sales of other investments | 204 | 107 |
| Proceeds from prepayments and maturities of other investments | 3 | 2 |
| Net decrease (increase) in loans, excluding acquisitions, sales and transfers | (2,501) | (3,061) |
| Proceeds from sales of portfolio loans | 100 | 89 |
| Proceeds from corporate-owned life insurance | 24 | 38 |
| Purchases of premises, equipment, and software | (79) | (40) |
| Proceeds from sales of premises and equipment | — | 1 |
| Proceeds from sales of OREO | 13 | 16 |
| NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES | (4,444) | (1,437) |
| FINANCING ACTIVITIES | | |
| Net increase (decrease) in deposits, excluding acquisitions | 4,147 | (925) |
| Net increase (decrease) in short-term borrowings | (2,193) | 86 |
| Net proceeds from issuance of long-term debt | 2,078 | 4,054 |
| Payments on long-term debt | (533) | (1,582) |

| | | |
|---|---------|----------|
| Issuance of preferred shares | 519 | — |
| Repurchase of common shares | (73 |) (448) |
| Net proceeds from reissuance of common shares | 5 | 19 |
| Cash dividends paid | (224 |) (199) |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | 3,726 | 1,005 |
| NET INCREASE (DECREASE) IN CASH AND DUE FROM BANKS | 142 | (183) |
| CASH AND DUE FROM BANKS AT BEGINNING OF PERIOD | 607 | 653 |
| CASH AND DUE FROM BANKS AT END OF PERIOD | \$749 | \$470 |
| Additional disclosures relative to cash flows: | | |
| Interest paid | \$308 | \$256 |
| Income taxes paid (refunded) | 68 | 173 |
| Noncash items: | | |
| Common stock issued to acquire First Niagara | \$2,831 | — |
| Preferred stock issued to acquire First Niagara | 350 | — |
| Reduction of secured borrowing and related collateral | 59 | \$132 |
| Loans transferred to portfolio from held for sale | 8 | 1 |
| Loans transferred to held for sale from portfolio | 32 | 41 |
| Loans transferred to OREO | 15 | 16 |

See Notes to Consolidated Financial Statements (Unaudited).

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Notes to Consolidated Financial Statements (Unaudited)

1. Basis of Presentation and Accounting Policies

As used in these Notes, references to “Key,” “we,” “our,” “us,” and similar terms refer to the consolidated entity consisting of KeyCorp and its subsidiaries. KeyCorp refers solely to the parent holding company, and KeyBank refers to KeyCorp’s subsidiary, KeyBank National Association. First Niagara Bank refers to First Niagara Bank, National Association, a subsidiary of KeyCorp as of September 30, 2016, which was subsequently merged with and into KeyBank in the fourth quarter of 2016.

The acronyms and abbreviations identified below are used in the Notes to Consolidated Financial Statements (Unaudited) as well as in the Management’s Discussion & Analysis of Financial Condition & Results of Operations. You may find it helpful to refer back to this page as you read this report.

References to our “2015 Form 10-K” refer to our Form 10-K for the year ended December 31, 2015, which was filed with the U.S. Securities and Exchange Commission and is available on its website (www.sec.gov) and on our website (www.key.com/ir).

| | |
|--|--|
| AICPA: American Institute of Certified Public Accountants. | KEF: Key Equipment Finance. |
| ALCO: Asset/Liability Management Committee. | KPP: Key Principal Partners. |
| ALLL: Allowance for loan and lease losses. | KREEC: Key Real Estate Equity Capital, Inc. |
| A/LM: Asset/liability management. | LCR: Liquidity coverage ratio. |
| AOCI: Accumulated other comprehensive income (loss). | LIBOR: London Interbank Offered Rate. |
| APBO: Accumulated postretirement benefit obligation. | LIHTC: Low-income housing tax credit. |
| Austin: Austin Capital Management, Ltd. | Moody’s: Moody’s Investor Services, Inc. |
| BHCs: Bank holding companies. | MRM: Market Risk Management group. |
| Board: KeyCorp Board of Directors. | N/A: Not applicable. |
| CCAR: Comprehensive Capital Analysis and Review. | NASDAQ: The NASDAQ Stock Market LLC. |
| CMBS: Commercial mortgage-backed securities. | NAV: Net asset value. |
| CMO: Collateralized mortgage obligation. | N/M: Not meaningful. |
| Common shares: KeyCorp common shares, \$1 par value. | NOW: Negotiable Order of Withdrawal. |
| DIF: Deposit Insurance Fund of the FDIC. | NPR: Notice of proposed rulemaking. |
| Dodd-Frank Act: Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. | NYSE: New York Stock Exchange. |
| EBITDA: Earnings before interest, taxes, depreciation, and amortization. | OCC: Office of the Comptroller of the Currency. |
| EPS: Earnings per share. | OCI: Other comprehensive income (loss). |
| ERISA: Employee Retirement Income Security Act of 1974. | OREO: Other real estate owned. |
| ERM: Enterprise risk management. | OTTI: Other-than-temporary impairment. |
| EVE: Economic value of equity. | PBO: Projected benefit obligation. |
| FASB: Financial Accounting Standards Board. | PCI: Purchased credit impaired. |
| FDIC: Federal Deposit Insurance Corporation. | S&P: Standard and Poor’s Ratings Services, a Division of The McGraw-Hill Companies, Inc. |
| Federal Reserve: Board of Governors of the Federal Reserve System. | SEC: U.S. Securities and Exchange Commission. |
| FHLB: Federal Home Loan Bank of Cincinnati. | Series A Preferred Stock: KeyCorp’s 7.750% Noncumulative Perpetual Convertible Preferred Stock, Series A. |
| FHLMC: Federal Home Loan Mortgage Corporation. | SIFIs: Systemically important financial institutions including BHCs with total consolidated assets of at least \$50 billion and nonbank financial companies designated by FSOC for supervision by the Federal Reserve. |
| First Niagara: First Niagara Financial Group, Inc. (NASDAQ: FNFG). | |
| FNMA: Federal National Mortgage Association, or Fannie Mae. | |

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FSOC: Financial Stability Oversight Council.

GAAP: U.S. generally accepted accounting principles.

GNMA: Government National Mortgage Association.

ISDA: International Swaps and Derivatives Association.

KAHC: Key Affordable Housing Corporation.

KCC: Key Capital Corporation.

KCDC: Key Community Development Corporation.

TDR: Troubled debt restructuring.

TE: Taxable-equivalent.

U.S. Treasury: United States Department of the Treasury.

VaR: Value at risk.

VEBA: Voluntary Employee Beneficiary Association.

VIE: Variable interest entity.

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The consolidated financial statements include the accounts of KeyCorp and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Some previously reported amounts have been reclassified to conform to current reporting practices.

The consolidated financial statements include any voting rights entities in which we have a controlling financial interest. In accordance with the applicable accounting guidance for consolidations, we consolidate a VIE if we have: (i) a variable interest in the entity; (ii) the power to direct activities of the VIE that most significantly impact the entity's economic performance; and (iii) the obligation to absorb losses of the entity or the right to receive benefits from the entity that could potentially be significant to the VIE (i.e., we are considered to be the primary beneficiary). Variable interests can include equity interests, subordinated debt, derivative contracts, leases, service agreements, guarantees, standby letters of credit, loan commitments, and other contracts, agreements, and financial instruments. See Note 10 ("Variable Interest Entities") for information on our involvement with VIEs.

We use the equity method to account for unconsolidated investments in voting rights entities or VIEs if we have significant influence over the entity's operating and financing decisions (usually defined as a voting or economic interest of 20% to 50%, but not controlling). Unconsolidated investments in voting rights entities or VIEs in which we have a voting or economic interest of less than 20% generally are carried at cost. Investments held by our registered broker-dealer and investment company subsidiaries (principal investing entities and Real Estate Capital line of business) are carried at fair value.

We believe that the unaudited consolidated interim financial statements reflect all adjustments of a normal recurring nature and disclosures that are necessary for a fair presentation of the results for the interim periods presented. The results of operations for the interim period are not necessarily indicative of the results of operations to be expected for the full year. The interim financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our 2015 Form 10-K.

In preparing these financial statements, subsequent events were evaluated through the time the financial statements were issued. Financial statements are considered issued when they are widely distributed to all shareholders and other financial statement users, or filed with the SEC.

Offsetting Derivative Positions

In accordance with the applicable accounting guidance, we take into account the impact of bilateral collateral and master netting agreements that allow us to settle all derivative contracts held with a single counterparty on a net basis, and to offset the net derivative position with the related cash collateral when recognizing derivative assets and liabilities. Additional information regarding derivative offsetting is provided in Note 8 ("Derivatives and Hedging Activities").

Loans Held for Sale

Our loans held for sale at September 30, 2016, December 31, 2016, and September 30, 2015, are disclosed in Note 4 ("Loans and Loans Held for Sale"). Our commercial loans, which we originated and intend to sell, are carried at the lower of aggregate cost or fair value. Beginning with the third quarter of 2016, we elected the fair value option for our real estate - residential mortgages. Fair value is determined based on available market data for similar assets, expected cash flows, and appraisals of underlying collateral or the credit quality of the borrower. Additional information regarding fair value measurements associated with our loans held for sale is provided in Note 6 ("Fair Value Measurements"). If a loan is transferred from the loan portfolio to the held-for-sale category, any write-down in the carrying amount of the loan at the date of transfer is recorded as a charge-off. Subsequent declines in fair value are recognized as a charge to noninterest income. Subsequent increases in fair for the real estate — residential loans are recorded to noninterest income. When a loan is placed in the held-for-sale category, we stop amortizing the related

deferred fees and costs. The remaining unamortized fees and costs are recognized as part of the cost basis of the loan at the time it is sold.

Purchased Loans

We evaluate purchased loans for impairment in accordance with the applicable accounting guidance. Purchased performing loans that do not have evidence of deterioration in credit quality at acquisition are recorded at fair value at the acquisition date. Any premium or discount associated with purchased performing loans is recognized as an expense or income based on the effective yield method of amortization. Subsequent to the purchase date, the methods utilized to estimate the required ALLL for these loans is similar to originated loans; however, we record a provision for loan losses only when the required ALLL exceeds any remaining purchase discount.

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Purchased loans that have evidence of deterioration in credit quality since origination and for which it is probable, at acquisition, that all contractually required payments will not be collected, are deemed PCI. Revolving loans, including lines of credit and credit card loans, leases, and loans where cash flows cannot be reasonably estimated are excluded from PCI accounting. Purchased loans are initially recorded at fair value without recording an allowance for loan losses. Fair value of these loans is determined using market participant assumptions in estimating the amount and timing of both principal and interest cash flows expected to be collected, as adjusted for an estimate of future credit losses and prepayments, and then a market-based discount rate is applied to those cash flows. PCI loans that have similar risk characteristics, primarily credit risk, collateral type and interest rate risk, and are homogeneous in size, are pooled and accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows. PCI loans that cannot be aggregated into a pool are accounted for individually.

Under the applicable accounting guidance for PCI loans, the excess of cash flows expected to be collected, measured as of the acquisition date, over the estimated fair value is referred to as the “accretable yield” and is recognized in interest income over the remaining life of the loan or pool using the effective yield method. Accordingly, PCI loans are not subject to classification as nonaccrual (and nonperforming) in the same manner as originated loans. Rather, acquired PCI loans are considered to be accruing loans because their interest income relates to the accretable yield recognized on the individual loan or pool and not to the contractual interest payments of the loan. The difference between the contractually required principal and interest payments as of the acquisition date and the cash flows expected to be collected is referred to as the “nonaccretable difference.” The nonaccretable difference, which is not accreted into income, reflects estimated future credit losses and uncollectible contractual interest expected to be incurred over the life of the PCI loan.

After we acquire loans determined to be PCI loans, actual cash collections are monitored to determine if they conform to management’s expectations. Revised cash flow expectations are prepared each period. A decrease in expected cash flows in subsequent periods may indicate impairment and would require us to establish an ALLL by recording a charge to the provision for loan losses. An increase in expected cash flows in subsequent periods initially reduces any previously established ALLL by the increase in the present value of cash flows expected to be collected, and requires us to recalculate the amount of accretable yield for the PCI loan or pool. The adjustment of accretable yield due to an increase in expected cash flows is accounted for as a change in estimate. The additional cash flows expected to be collected are reclassified from the nonaccretable difference to the accretable yield, and the amount of periodic accretion is adjusted accordingly over the remaining life of the PCI loan or pool.

A PCI loan may be derecognized either through receipt of payment (in full or in part) from the borrower, the sale of the loan to a third party, foreclosure of the collateral, or charge-off. If one of these events occurs, the loan should be removed from the loan pool, or derecognized if it is accounted for as an individual loan. PCI loans subject to modification are not removed from a PCI pool even if those loans would otherwise be deemed TDRs since the pool, and not the individual loan, represents the unit of account. Individually accounted for PCI loans that are modified in a TDR are no longer classified as PCI loans and are subject to TDR recognition.

Accounting Guidance Adopted in 2016

Business combinations. In September 2015, the FASB issued new accounting guidance that obligates an acquirer in a business combination to recognize adjustments to provisional amounts in the reporting period that the amounts were determined, eliminating the requirement for retrospective adjustments. The acquirer should record in the current period any income effects that resulted from the change in provisional amounts, calculated as if the accounting were completed at the acquisition date. This accounting guidance was effective prospectively for interim and annual reporting periods beginning after December 15, 2015 (effective January 1, 2016, for us). Early adoption was permitted. The adoption of this accounting guidance did not affect our financial condition or results of operations.

Fair value measurement. In May 2015, the FASB issued new disclosure guidance that eliminates the requirement to categorize investments measured using the net asset value practical expedient in the fair value hierarchy table. Entities are required to disclose the fair value of investments measured using the net asset value practical expedient so that financial statement users can reconcile amounts reported in the fair value hierarchy table to amounts reported on the balance sheet. This disclosure guidance was effective for interim and annual reporting periods beginning after December 15, 2015 (March 31, 2016, for us) on a retrospective basis. Early adoption was permitted. The adoption of this disclosure guidance did not affect our financial condition or results of operations. We provide the disclosure related to this new guidance in Note 5 ("Fair Value Measurements").

Cloud computing fees. In April 2015, the FASB issued new accounting guidance that clarifies a customer's accounting for fees paid in a cloud computing arrangement. If a cloud computing arrangement includes a software license, then the customer

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should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. This accounting guidance was effective for interim and annual reporting periods beginning after December 15, 2015 (effective January 1, 2016, for us) and could be implemented using either a prospective method or a retrospective method. Early adoption was permitted. We elected to implement this new accounting guidance using a prospective approach. The adoption of this accounting guidance did not affect our financial condition or results of operations.

Imputation of interest. In April 2015, the FASB issued new accounting guidance that requires debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. This accounting guidance was effective retrospectively for interim and annual reporting periods beginning after December 15, 2015 (effective January 1, 2016, for us). Early adoption was permitted. The adoption of this accounting guidance did not have a material effect on our financial condition or results of operations.

Consolidation. In February 2015, the FASB issued new accounting guidance that changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The new guidance amends the current accounting guidance to address limited partnerships and similar legal entities, certain investment funds, fees paid to a decision maker or service provider, and the impact of fee arrangements and related parties on the primary beneficiary determination. This accounting guidance was effective for interim and annual reporting periods beginning after December 15, 2015 (effective January 1, 2016, for us) and was implemented using a modified retrospective basis. Retrospective application to all relevant prior periods and early adoption was permitted. The adoption of this accounting guidance did not affect our financial condition or results of operations. Our Principal Investing unit and the Real Estate Capital line of business have equity and mezzanine investments, which were subjected to the new guidance. We determined these investments are VIEs. We provide disclosures related to our variable interest entities as required by the new guidance in Note 9 (“Variable Interest Entities”).

Derivatives and hedging. In November 2014, the FASB issued new accounting guidance that clarifies how current guidance should be interpreted when evaluating the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share. An entity should consider all relevant terms and features, including the embedded derivative feature being evaluated for bifurcation, when evaluating the nature of a host contract. This accounting guidance was effective for interim and annual reporting periods beginning after December 15, 2015 (effective January 1, 2016, for us) and could be implemented using a modified retrospective basis. Retrospective application to all relevant prior periods and early adoption was permitted. The adoption of this accounting guidance did not affect our financial condition or results of operations.

Consolidation. In August 2014, the FASB issued new accounting guidance that clarifies how to measure the financial assets and the financial liabilities of a consolidated collateralized financing entity. This accounting guidance was effective for interim and annual reporting periods beginning after December 15, 2015 (effective January 1, 2016, for us) and could be implemented using either a retrospective method or a cumulative-effect approach. Early adoption was permitted. The adoption of this accounting guidance did not affect our financial condition or results of operations.

Stock-based compensation. In June 2014, the FASB issued new accounting guidance that clarifies how to account for share-based payments when the terms of an award provide that a performance target could be achieved after the requisite service period. This accounting guidance was effective for interim and annual reporting periods beginning after December 15, 2015 (effective January 1, 2016, for us) and could be implemented using either a retrospective method or a prospective method. Early adoption was permitted. We elected to implement this new accounting guidance using a prospective approach. The adoption of this accounting guidance did not affect our financial condition

or results of operations.

Accounting Guidance Pending Adoption at September 30, 2016

Consolidation. In October 2016, the FASB issued new accounting guidance that amends the previous consolidation guidance issued in February 2015, to require a decision maker that holds an interest in a VIE through an entity under common control to only consider its proportionate indirect interest in the VIE in determining whether the decision maker is the VIE's primary beneficiary. This new guidance eliminates the requirement that a decision maker treat the common control party's interest in the VIE as if the decision maker held the interest itself, an approach referred to as "full attribution." The new guidance will be effective for interim and annual reporting periods beginning after December 15, 2016 (effective January 1, 2017, for us), and it must be applied retrospectively to all periods beginning with the fiscal year that the previous guidance was initially applied. Early adoption is permitted. The adoption of this accounting guidance is not expected to have a material effect on our financial condition or results of operations.

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Income taxes. In October 2016, the FASB issued accounting guidance requiring an entity to recognize any deferred taxes from an intra-entity transfer of an asset other than inventory when the transfer occurs. This accounting guidance will be effective for annual and interim reporting periods beginning after December 15, 2017 (effective January 1, 2018, for us) and should be implemented using a modified-retrospective approach. Early adoption is permitted but only as of the beginning of an annual reporting period for which financial statements have not yet been issued. We are currently evaluating the impact that this accounting guidance may have on our financial condition or results of operations.

Statement of cash flows. In August 2016, the FASB issued new accounting guidance that clarifies how cash receipts and cash payments in certain specific transactions should be presented and classified in the statement of cash flows. These specific transactions include, but are not limited to, debt prepayment or extinguishment costs, contingent considerations made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate owned life insurance policies, and distributions from equity method investees. This guidance also clarifies that in instances of cash flows with multiple aspects that cannot be separately identified, classification should be based on the activity that is likely to be the predominant source of or use of cash flow. This accounting guidance will be effective for interim and annual reporting periods beginning after December 15, 2017 (effective January 1, 2018, for us) and should be implemented using a retrospective approach. Early adoption is permitted. We are currently evaluating the impact that this accounting guidance may have on our financial condition or results of operations.

Financial instruments. In June 2016, the FASB issued new accounting guidance that changes the methodology for recognizing credit losses related to financial instruments. Under current GAAP, a credit loss is not recognized until it is probable the loss has been incurred. The new accounting guidance eliminates that threshold and expands the information required for an entity to consider when developing an estimate of expected credit losses, including the use of forecasted information. Entities will be required to present financial assets measured on an amortized cost basis at the net amount that is expected to be collected. This new guidance will impact the accounting for our loans, debt securities available for sale, and liability for credit losses on unfunded lending-related commitments as well as purchased financial assets with a more than insignificant amount of credit deterioration since origination. This accounting guidance will be effective for interim and annual reporting periods beginning after December 15, 2019 (effective January 1, 2020, for us). Early adoption is permitted but only for interim and annual reporting periods beginning after December 15, 2018. This guidance must be implemented using a modified retrospective basis except a prospective approach must be used for debt securities for which an other-than-temporary impairment had been recognized before the effective date. A prospective transition approach also should be used for purchased financial assets with credit deterioration. We are currently evaluating the impact that this accounting guidance may have on our financial condition or results of operations.

Stock-based compensation. In March 2016, the FASB issued new accounting guidance that simplifies accounting for several aspects of share-based payment transactions, including income tax consequences, classification of awards as either equity or liabilities, and presentation on the statement of cash flows. This accounting guidance will be effective for interim and annual reporting periods beginning after December 15, 2016 (effective January 1, 2017, for us). The method of transition is dependent on the particular amendment within the new guidance. Early adoption is permitted. The adoption of this accounting guidance is not expected to have a material effect on our financial condition or results of operations.

Equity method investments. In March 2016, the FASB issued new accounting guidance that simplifies the transition to equity method accounting by eliminating the requirement for an investor to make retroactive adjustments to the investment, results of operations, and retained earnings on a step-by-step basis when an investment becomes qualified for equity method accounting. Instead, when an investment qualifies for the equity method due to an increase in

ownership or degree of influence, an equity method investor is required to add the cost of acquiring the additional interest to the current basis of the previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for the equity method. This accounting guidance will be effective prospectively for interim and annual reporting periods beginning after December 15, 2016 (effective January 1, 2017, for us). Early adoption is permitted. The adoption of this accounting guidance is not expected to have a material effect on our financial condition or results of operations.

Derivatives and hedging. In March 2016, the FASB issued new accounting guidance that requires an entity to use a four-step decision model when assessing contingent call (put) options that can accelerate the payment of principal on debt instruments to determine whether they are clearly and closely related to their debt hosts. This accounting guidance will be effective for interim and annual reporting periods beginning after December 15, 2016 (effective January 1, 2017, for us) and must be implemented using a modified retrospective basis. Early adoption is permitted. The adoption of this accounting guidance is not expected to have a material effect on our financial condition or results of operations.

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Derivatives and hedging. In March 2016, the FASB issued new accounting guidance that clarifies that a change in the counterparty to a derivative instrument that has been designated as a hedging instrument does not, by itself, require dedesignation, but all other hedge accounting criteria must be met. This accounting guidance will be effective for interim and annual reporting periods beginning after December 15, 2016 (effective January 1, 2017, for us) and can be implemented using either a prospective method or a modified retrospective method. Early adoption is permitted. We have elected to implement this new accounting guidance using a prospective method. The adoption of this accounting guidance is not expected to have a material effect on our financial condition or results of operations.

Extinguishment of liabilities. In March 2016, the FASB issued new accounting guidance that clarifies that liabilities related to the sale of prepaid stored-value products are financial liabilities, and breakage should be accounted for under the breakage guidance in the new revenue recognition accounting guidance. It also provides clarity on how prepaid product liabilities should be derecognized. This accounting guidance will be effective for interim and annual reporting periods beginning after December 15, 2017 (effective January 1, 2018, for us) and can be implemented using either a modified retrospective approach or retrospective approach. The adoption of this accounting guidance is not expected to have a material effect on our financial condition or results of operations.

Leases. In February 2016, the FASB issued new accounting guidance that requires a lessee to recognize a liability to make lease payments and a right of use asset representing its right to use an underlying asset during the lease term for both finance and operating leases. The definition of a lease was modified to exemplify the concept of control over an asset identified in the lease. Lease classification criteria remains substantially similar to criteria in current lease guidance. The guidance defines which payments can be used in determining lease classification. For short-term leases with a term of 12 months or less, lessees can make a policy election not to recognize lease assets and lease liabilities. Lessor accounting is largely unchanged. Leveraged leases that commenced before the effective date of the new guidance are grandfathered. New disclosures are required, and certain practical expedients are allowed upon adoption. This accounting and disclosure guidance will be effective for interim and annual reporting periods beginning after December 15, 2018 (effective January 1, 2019, for us) and should be implemented using the modified retrospective approach. Early adoption is permitted. We are currently evaluating the impact that this accounting guidance may have on our financial condition or results of operations.

Financial instruments. In January 2016, the FASB issued new accounting guidance that requires equity investments, except those accounted for under the equity method of accounting or consolidated, to be measured at fair value with changes recognized in net income. If there is no readily determinable fair value, the guidance allows entities the ability to measure investments at cost less impairment, whereby impairment is based on a qualitative assessment. The guidance eliminates the requirement to disclose the methods and significant assumptions used to estimate the fair value of financial instruments measured at amortized cost and changes the presentation of financial assets and financial liabilities on the balance sheet or in the footnotes. If an entity has elected the fair value option to measure liabilities, the new accounting guidance requires the portion of the change in the fair value of a liability resulting from credit risk to be presented in OCI. We have not elected to measure any of our liabilities at fair value, and therefore, this aspect of the guidance is not applicable to us. This accounting and disclosure guidance will be effective for interim and annual reporting periods beginning after December 15, 2017 (effective January 1, 2018, for us). For the guidance applicable to us, the accounting will be implemented on a prospective basis, whereby early adoption is not permitted. We are currently evaluating the impact that this accounting guidance may have on our financial condition or results of operations.

Going concern. In August 2014, the FASB issued new accounting guidance that requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date the financial statements are issued. Disclosure is required when conditions or events raise substantial doubt about an entity's ability to continue as a going concern. This accounting guidance will be effective for interim and annual reporting periods beginning after December 15, 2016 (effective January 1, 2017, for us). Early adoption is permitted.

The adoption of this accounting guidance is not expected to have a material effect on our financial condition or results of operations.

Revenue recognition. In May 2014, the FASB issued new accounting guidance that revises the criteria for determining when to recognize revenue from contracts with customers and expands disclosure requirements. The core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides a five step model to be followed in making this determination. This accounting guidance can be implemented using either a retrospective method or a cumulative-effect approach. In August 2015, the FASB issued an update that defers the effective date of the revenue recognition guidance by one year. This new guidance will be effective for interim and annual reporting periods beginning after December 15, 2017 (effective January 1, 2018, for us). Early adoption is permitted but only for interim and annual reporting periods beginning after December 15, 2016. We have elected to implement this new accounting guidance using a cumulative-effect approach. We are currently in the process of gathering an inventory of contracts with customers and

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performing an in-depth assessment, though our preliminary analysis suggests that the adoption of this accounting guidance is not expected to have a material effect on our financial condition or results of operations. There are many aspects of this new accounting guidance that are still being interpreted, and the FASB has issued updates to certain aspects of the guidance to address implementation issues. For example, the FASB issued accounting guidance in March 2016 to clarify principal versus agent considerations and additional guidance in April 2016 to clarify the identification of performance obligations and the licensing implementation guidance. In May 2016, the FASB issued narrow-scope improvements related to collectability, sales tax and noncash consideration, and practical expedients for contract modifications and completed contracts. While certain implementation issues relevant to the industry are still pending resolution, including trade date versus settlement date recognition for broker dealers and the applicability of interchange revenues for card issuing banks, our preliminary conclusions reached as to the application of the new guidance are not expected to be significantly affected. We will continue to evaluate any impact as additional guidance is issued and as our internal assessment progresses.

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2. Business Combination

First Niagara

On August 1, 2016 (the "Acquisition Date"), we acquired all of the outstanding common shares of First Niagara, the parent company of First Niagara Bank, for total consideration of approximately \$4.0 billion and thereby acquired First Niagara Bank's approximately 390 branch locations across New York, Pennsylvania, Connecticut, and Massachusetts. The merger with First Niagara enabled us to expand in the New England market and into the Pennsylvania market, improve our core deposit base, and add additional scale in our banking operations. The results of First Niagara's operations are included in our consolidated financial statements from the Acquisition Date.

Under the terms of the merger agreement, each outstanding share of First Niagara common stock was converted into the right to receive 0.680 KeyCorp common shares and \$2.30 in cash, for a total per share value of \$10.26, based on the \$11.70 closing price of KeyCorp's stock on July 29, 2016. In the aggregate, First Niagara stockholders received 240 million shares of KeyCorp common stock. Also under the terms of the merger agreement, First Niagara employee stock options and restricted stock awards converted into options to purchase and receive KeyCorp common stock. These options and restricted stock awards had a fair value of \$26 million on the date of acquisition. Our methodology for valuing employee stock options is disclosed in Note 15 ("Employee Benefits") under the heading "Stock Options" on page 195 of our 2015 Form 10-K. Our methodology for valuing restricted stock awards is disclosed in Note 15 ("Employee Benefits") under the heading "Long-Term Incentive Compensation Program" on page 196 of our 2015 Form 10-K.

In addition, at the time of the merger, each share of First Niagara preferred stock, Series B, was converted into the right to receive a share of KeyCorp preferred stock, Series C, a newly created series of KeyCorp preferred stock. Additional information on this series of preferred stock is provided in Note 18 ("Shareholders' Equity").

On October 7, 2016, First Niagara Bank merged with and into KeyBank, with KeyBank as the surviving entity. Systems and client conversion also occurred during the fourth quarter of 2016 in connection with the bank merger.

The acquisition of First Niagara constituted a business combination and was accounted for under the acquisition method of accounting. Accordingly, the assets acquired, the liabilities assumed, and the consideration paid were recorded at their estimated fair value as of the acquisition date. These fair value estimates are considered preliminary and are subject to change for up to one year after the Acquisition Date as additional information becomes available.

The following table provides the purchase price calculation as of the Acquisition Date and the identifiable assets purchased and the liabilities assumed at their estimated fair value. These fair value measurements are based on internal and third-party valuations.

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in millions

Consideration paid:

| | |
|---|---------|
| KeyCorp common stock issued | \$2,831 |
| Cash payments to First Niagara stockholders | 811 |
| Exchange of First Niagara preferred stock for KeyCorp preferred stock | 350 |
| Total consideration paid | \$3,992 |

Statement of Net Assets Acquired at Fair Value:

ASSETS

| | |
|--|----------|
| Cash and due from banks and short-term investments | \$620 |
| Investment securities | 9,019 |
| Other investments | 297 |
| Loans | 23,504 |
| Premises and equipment | 276 |
| Other intangible assets | 388 |
| Accrued income and other assets | 1,449 |
| Total assets | \$35,553 |

LIABILITIES

| | |
|--|----------|
| Deposits | \$28,993 |
| Bank notes and other short-term borrowings | 2,698 |
| Accrued expense and other liabilities | 444 |
| Long-term debt | 846 |
| Total liabilities | \$32,981 |

| | |
|----------------------------------|---------|
| Net identifiable assets acquired | 2,572 |
| Goodwill | \$1,420 |

We estimated the fair value of loans acquired from First Niagara by utilizing the discounted cash flow method within the income approach. This methodology aggregates the purchased loans by category and risk rating. Cash flows for each category were determined by estimating future credit losses and the rate of prepayments. Projected monthly cash flows were then discounted to present value based on a market rate for similar loans. There was no carryover of First Niagara's allowance for loan losses associated with the loans we acquired. The valuation of the acquired loans was not completed prior to September 30, 2016, due to the relatively short time frame in which we had to complete the acquisition as well as the complexity involved in valuing loans. An estimate has been recorded based on the results of a valuation exercise conducted as of December 31, 2015, and applied to the August 1, 2016, balance of loans acquired from First Niagara. The valuation will be completed during the fourth quarter of 2016, and the value of the acquired loans will be adjusted accordingly.

Information about the acquired First Niagara loan portfolio as of the Acquisition Date is in the following table, and excludes lines of credit:

| | |
|--|---------|
| in millions | PCI |
| Contractual required payments receivable | \$1,132 |
| Nonaccretable difference | 109 |
| Expected cash flows | 1,023 |
| Accretable yield | 29 |
| Fair value | \$994 |

At the First Niagara Acquisition Date, the contractual required payments receivable on the purchased non-impaired loans totaled \$23.1 billion, with a corresponding fair value of \$22.5 billion. The estimated cash flows not expected to be collected at the Acquisition Date were \$466 million.

Intangible assets consisted of the core deposit intangible, the commercial purchased credit card receivable, the consumer purchased credit card receivable, and other intangible assets. The core deposit intangible asset recognized as part of the First Niagara merger of \$356 million is being amortized over its estimated useful life of approximately ten years utilizing an accelerated method. The commercial purchased credit card receivables recognized as part of the First Niagara merger are being amortized over their estimated useful life of approximately six years utilizing an accelerated method. The consumer purchased credit card receivables recognized as part of the First Niagara merger are being amortized over their estimated useful life of approximately nine years utilizing an accelerated method.

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Goodwill of \$1.4 billion was recorded as a result of the transaction and is not amortized for book purposes. \$1.1 billion of goodwill was assigned to our Key Community Bank segment and \$284 million of goodwill was assigned to our Key Corporate Bank segment. The goodwill recorded is not deductible for tax purposes. The following table shows the changes in the carrying amount of goodwill by reporting unit.

| | Key Community Bank | Key Corporate Bank | Total |
|--|--------------------------|--------------------------|---------|
| in millions | | | |
| BALANCE AT DECEMBER 31, 2014 | \$ 979 | \$ 78 | \$1,057 |
| Impairment losses based on results of interim impairment testing | — | — | — |
| Tax adjustment resulting from Pacific Crest Securities acquisition | — | 3 | 3 |
| BALANCE AT DECEMBER 31, 2015 | 979 | 81 | 1,060 |
| Acquisition of First Niagara | 1,136 | 284 | 1,420 |
| BALANCE AT SEPTEMBER 30, 2016 | \$ 2,115 | \$ 365 | \$2,480 |

Certificates of deposit were valued by projecting out the expected cash flows based on the contractual terms of the certificates of deposit. The fair values of savings and transaction deposit accounts acquired from First Niagara were assumed to approximate the carrying value as these accounts have no stated maturity and are payable on demand. These cash flows were discounted based on a market rate for a certificate of deposit with a corresponding maturity.

Direct acquisition costs related to the First Niagara acquisition were expensed as incurred and amounted to \$43 million for the nine months ended September 30, 2016. Professional fees and charitable contributions comprised the majority of these direct acquisition costs, franchise and business taxes and other noninterest expenses. These direct acquisition costs are part of our total merger-related charges.

The following table presents financial information regarding the former First Niagara operations included in our Consolidated

Statement of Income from the Acquisition Date through September 30, 2016, under the column “Actual from acquisition date through September 30, 2016.” These amounts do not include merger-related charges. In addition, the following table presents unaudited pro forma information as if the acquisition of First Niagara had occurred on January 1, 2015, under the “Pro forma” column. This pro forma information gives effect to certain adjustments, including purchase accounting fair value adjustments, amortization of core deposit and other intangibles, and related income tax effects. Merger-related charges related to the First Niagara merger that we incurred during the nine months ended September 30, 2016, are not reflected in the unaudited pro forma amounts. The pro forma information does not necessarily reflect the results of operations that would have occurred had KeyCorp merged with First Niagara at the beginning of 2015. Cost savings are also not reflected in the unaudited pro forma amounts for the nine months ended September 30, 2016, and 2015.

| | Actual from acquisition date through September 30, 2016 | Pro forma Nine months ended September 30, 2016 | 2015 |
|--------------------------|---|--|---------|
| in millions | | | |
| Net interest income (TE) | \$ 175 | \$2,674 | \$2,599 |
| Noninterest income | 53 | 1,625 | 1,635 |

| | | | |
|---|----|-----|-----|
| Net income (loss) attributable to common shareholders | 48 | 849 | 873 |
|---|----|-----|-----|

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3. Earnings Per Common Share

Basic earnings per share is the amount of earnings (adjusted for dividends declared on our preferred stock) available to each common share outstanding during the reporting periods. Diluted earnings per share is the amount of earnings available to each common share outstanding during the reporting periods adjusted to include the effects of potentially dilutive common shares. Potentially dilutive common shares include incremental shares issued for the conversion of our convertible Series A Preferred Stock, stock options, and other stock-based awards. Potentially dilutive common shares are excluded from the computation of diluted earnings per share in the periods where the effect would be antidilutive. For diluted earnings per share, net income available to common shareholders can be affected by the conversion of our convertible Series A Preferred Stock. Where the effect of this conversion would be dilutive, net income available to common shareholders is adjusted by the amount of preferred dividends associated with our Series A Preferred Stock.

Our basic and diluted earnings per common share are calculated as follows:

| | Three months ended September 30, | | Nine months ended September 30, | |
|--|----------------------------------|---------|---------------------------------|---------|
| | 2016 | 2015 | 2016 | 2015 |
| dollars in millions, except per share amounts | | | | |
| EARNINGS | | | | |
| Income (loss) from continuing operations | \$ 172 | \$ 220 | \$ 557 | \$ 686 |
| Less: Net income (loss) attributable to noncontrolling interests | 1 | (2) | — | 1 |
| Income (loss) from continuing operations attributable to Key | 171 | 222 | 557 | 685 |
| Less: Dividends on Series A Preferred Stock | 6 | 6 | 17 | 17 |
| Income (loss) from continuing operations attributable to Key common shareholders | 165 | 216 | 540 | 668 |
| Income (loss) from discontinued operations, net of taxes ^(a) | 1 | (3) | 5 | 5 |
| Net income (loss) attributable to Key common shareholders | \$ 166 | \$ 213 | \$ 545 | \$ 673 |
| WEIGHTED-AVERAGE COMMON SHARES | | | | |
| Weighted-average common shares outstanding (000) | 982,080 | 981,430 | 880,824 | 849,758 |
| Effect of convertible preferred stock | — | — | — | — |
| Effect of common share options and other stock awards | 12,580 | 10,450 | 8,965 | 7,613 |
| Weighted-average common shares and potential common shares outstanding (000) ^(b) | 994,660 | 991,880 | 889,789 | 857,371 |
| EARNINGS PER COMMON SHARE | | | | |
| Income (loss) from continuing operations attributable to Key common shareholders | \$.17 | \$.26 | \$.61 | \$.79 |
| Income (loss) from discontinued operations, net of taxes ^(a) | — | — | .01 | .01 |
| Net income (loss) attributable to Key common shareholders ^(c) | .17 | .26 | .62 | .80 |
| Income (loss) from continuing operations attributable to Key common shareholders — assuming dilution | \$.16 | \$.26 | \$.60 | \$.78 |
| Income (loss) from discontinued operations, net of taxes ^(a) | — | — | .01 | .01 |
| Net income (loss) attributable to Key common shareholders — assuming dilution ^(d) | .17 | .25 | .61 | .79 |

In September 2009, we decided to discontinue the education lending business conducted through Key Education Resources, the education payment and financing unit of KeyBank. As a result of this decision, we have accounted for this business as a discontinued operation. For further discussion regarding the income (loss) from discontinued operations, see Note 12 (“Acquisition, Divestiture, and Discontinued Operations”).

- (b) Assumes conversion of common share options and other stock awards and/or convertible preferred stock, as applicable.
- (c) EPS may not foot due to rounding.

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4. Loans and Loans Held for Sale

Our loans by category are summarized as follows:

| in millions | September 30, 2016 | December 31, 2015 | September 30, 2015 |
|---|-----------------------|----------------------|-----------------------|
| Commercial, financial and agricultural ^(a) | \$ 39,433 | \$ 31,240 | \$ 31,095 |
| Commercial real estate: | | | |
| Commercial mortgage | 14,979 | 7,959 | 8,180 |
| Constr | | | |